GOVERNMENT OF INDIA
FINANCE
LOK SABHA

UNSTARRED QUESTION NO:4178
ANSWERED ON:14.12.2001
RBI GUIDELINES FOR MARGIN TRADING
SUDARSANA E.M. NATCHIAPPAN

Will the Minister of FINANCE be pleased to state:

(a) the details about the guidelines issued by the Reserve Bank of India for introduction of margin trading;

(b) the salient features of the individual stock options and the margin trading;

(c) the reasons for the delay for the merge of the Delhi Stock Exchange with the Bombay Stock Exchange (BSE);

(d) whether there is an allegation about the transfering of the Exchange`s fund to a subsidiary company as the very purpose of forming subsidiary is to illegally transfer Rs. 6 crore out of the funds of the exchange to the subsidiary of the brokers; and

(e) if so, the details thereof?

Answer

MINISTER OF STATE IN THE MINISTRY OF FINANCE (SHRI BALASAHEB VIKHE PATIL)

(a): Reserve Bank of India (RBI) has issued guidelinesfor margin trading on September 22, 2001 permitting banks, to extend finance to stockbrokers for margin trading within the overall ceiling of 5% prescribed for exposure of banks to the capital market.

(b): According to SEBI, it has permitted the trading onstock option contracts on 31 stocks on the derivative segment of the stock exchange, Mumbai (BSE) and the futuresand options segment of National stock exchange (NSE) onJuly 2, 2001. Salient features of individual stock options are :

1. Premium settled American style stock options, settled in cash at exercise, for an initial period which would later be shifted to physical settlement.

2. Each stock option contract has a minimum contract size of Rs.2 lakhs at the time of its introduction.

3. Each stock option contract can have a maximum maturity of 12 months and should have a minimum of 3 strikes (in the money, near the money and out of the money). Currently, there are 1 month, 2 month and 3 month option contracts being traded on the 31 stocks.

4. The premium on the stock options is collected from the buyers in cash and paid out to the sellers in cash on T+1 day.

5. The initial margin requirements on the 31 stock option contracts is based on the worst case loss of a portfolio of an individual client to cover 99% VAR over a one day horizon. The initial margin requirement is netted at the level of the individual client and is collected on a gross basis at the level of trading/clearing member.

6. The computation of worst scenario loss based on the latest scenario contract values is applied to member/client portfolios on a real time basis.

7. A portfolio based margining approach is adopted which takes an integrated view of the risk involved in the portfolio of each individual client consisting of his positions in derivative contracts.

8. Exposure limits: The notional value of gross openpositions at any point in time shall not exceed 20 times the liquid networth of a member. Hence 5% of the notional value of gross short open position in stock option contracts is collected/adjusted from the liquid networth of a member on a real time basis.

9. Position limits: A consolidated position limit for stock options and single stock futures on a particular underlying has been prescribed for a trading member at higher of Rs. 50 crores or 7.5% of the open interest in all derivative contracts in that underlying. Similarly there is a marketwide limit on the consolidated open position for both stock options and single stock futures on a particular underlying which is lower of 30 times the average number of shares traded daily during the previous calendar month, in the cash segment of the exchange or 10% of the number of shares held by non-promoters i.e., 10% of the free float, in terms of number of shares of a company.

The salient features of margin trading are :

• Banks would be allowed to provide finance to stock brokers for the purpose of margin trading in actively traded scrips forming part of NSE NIFTY and BSE Sensex within overall ceiling of 5% prescribed for bank exposure to capital market.

• The minimum margin to be maintained by the banks is 40%.

• Banks to put in place an appropriate system for monitoring and maintaining the margin of 40% on a regular basis.

• Further the bank`s Board is required to prescribe and review necessary safeguards in respect of margin trading.

• The total finance extended of margin trading is to be disclosed by the banks in the `Notes to the Account` to their balance sheets.

• The RBI-SEBI Technical committee will again review the guidelines in June 2002.

(c): SEBI has intimated that the Stock Exchange, Mumbai (BSE) and the Delhi Stock Exchange Association Ltd (DSE) are considering a proposal to consolidate the two exchanges. This issue has been placed before the Boards of both the exchanges. The Board of Directors of the DSE and the Governing Board of the BSE have accorded `in-principle` approval to the scheme. However, there are various issues involved in the scheme for both the exchanges regarding interest of the members, staff of the exchanges and the process of valuation. The scheme can be completed once these issues are sorted and it is approved by the Boards of both the exchanges.

(d) & (e): In the Annual General Meeting of the DSE held on December 20, 2000, as reported by the Delhi Stock Exchange it was decided to donate and/or gift to DSE Securities Ltd (a subsidiary of DSE) a sum of Rs. 6 crores or such higher sums as may be approved by the Board of Directors. DSE convened a meeting of the Board of Directors on 27th June, 2001 to discuss the donation and/or gift of Rs. 3.5 crores to the subsidiary company. Some of the Nominee Directors on the DSE Board, objected to the proposal, and the matter was not considered by the DSE Board again.